

# OPPORTUNITIES IN THE PHILIPPINE ONLINE GAMING INDUSTRY

(April 2005)

## Summary

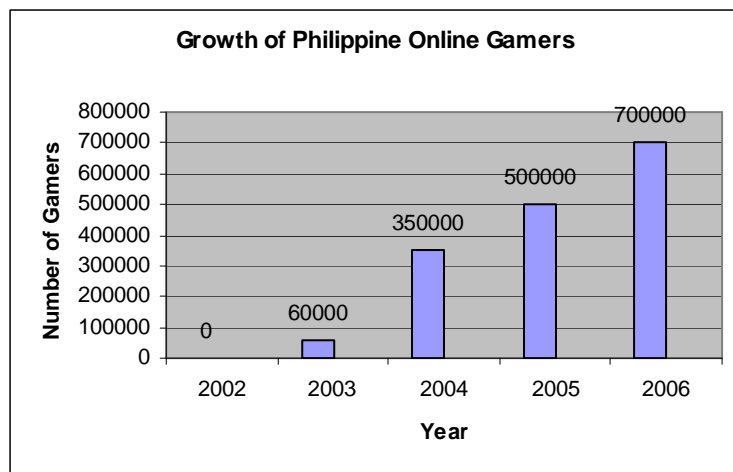
The Philippine online gaming market is experiencing spectacular growth, reaching US\$10 million and 350,000 subscribers in 2004 (up from \$3 million and 60,000 subscribers in 2003), according to International Data Corp (IDC) <sup>1</sup>. With an estimated 40% annual increase in subscribers, online gaming has ceased to be just an ordinary pastime or amusement; it has become the most dynamic segment of the entertainment software industry in the Philippines. Opportunities abound for U.S. online game content developers, broadband service providers, and suppliers of servers, switches, new and refurbished PCs, and gaming and PC accessories.

## Market Overview

At the end of 2004, PC penetration in the Philippines stood at 1.82%, or 1.53 million PCs for a population of 84 million, according to data from the National Telecommunications Commission (NTC) and key industry players. Five million people are estimated to have Internet access through PCs at home, schools, corporate offices and Internet cafés. 80% of Internet users still access the net through dial-up connections.

As of 2004, there were approximately 300 Internet Service Providers (ISPs) and ISP Value-Added Resellers (VARs) registered with the NTC. 10 to 15 of these are major players, including the large telecommunications operators. ISP market leaders are Infocomm, a subsidiary of the Philippine Long Distance Telephone Company (PLDT); GlobeNet, under Globe Telecom; Pacific Internet, a Singapore-based ISP; Mosaic Communications and Tridel Technologies.

As shown below, online gaming market growth is expected to accelerate in coming years. In January 2003 the first commercial online game was released, but real growth has been and will continue to be driven by massively multiplayer online role-playing games (MMORPGs), the first of which was released in September 2003.



Source: Industry Interviews

<sup>1</sup> Used with written permission from IDC

Today, MMORPGs dominate the industry. MMORGS are “sprawling virtual worlds in which players interact with fellow players by controlling one or more characters.”<sup>2</sup> They allow multiple individuals from all over the country (in some cases, from different parts of the world) and from different walks of life to interact in dynamic, virtual communities. Because they serve as a venue for community building and self-expression by immersing thousands of gamers into “socially interactive virtual gaming adventure worlds,” MMORPGs represent the next generation in digital entertainment in the Philippines.

### **Market Trends**

For the foreseeable future, online gaming will remain the trend in the Philippine digital entertainment industry (as opposed to PC-based games). This trend is predicted grow stronger for the following reasons:

- ⌚ Adaptability to Philippine culture.  
Online games are interactive, unpredictable, all-inclusive, and continue to evolve even when the player logs off. By the time a player logs on again, real time has elapsed. This draws the typical Philippine player to log on as often as possible, as not to be left behind. Also, because content providers allow the Philippine publishers to localize the games, they can adapt them to Filipino preferences.
- ⌚ Addresses the major issue of Piracy  
PC based games are prone to piracy. In fact, some estimate that 90% of PC games sold in the Philippines are pirated copies. Online gaming content providers address piracy by providing the interface software for free or selling it at a relatively low price. (i.e. Users download the game from the Web or from CDs distributed for free in Internet cafés, in magazines or during events.) In order to play the game, however, users must log on to a secure Internet site and pay the associated fee. Since the game software cannot be played without logging on to the website, it is of little worth to pirate the interface software.
- ⌚ The Philippine preference for “sachet” marketing, or purchasing small portions one at a time.  
“There is no front-end cost for the customer” is how one industry insider describes the sachet marketing approach to online gaming.

In short, the game is distributed for free to potential end users, who purchase access to the game in short snippets, via a pre-paid access card. Because the consumer spends less at the time of purchase, his purchase is viewed as being economical. In reality however, consumers end up spending more by buying smaller portions one at a time.

### **Market Opportunities**

“To a certain degree, gaming will help us achieve our goal of developing the Philippine digital infrastructure,” claims Mr. Virgilio Peña, Chairman of the Commission on Information Technology and Communications Technology (CICT), the Philippine government’s highest policy-making body on ICT matters.

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<sup>2</sup> January 2005, INQ7.net, Hackenslash

As a catalyst for growing the Philippine IT infrastructure, online gaming is providing market opportunities in the following local sub sectors:

🕒 The Internet Café Industry

Online gaming has revived the Philippine Internet Café industry. Apart from its business and educational uses, Internet Cafés used to survive on network games. Owners typically paid a licensing fee for network games to be available in their facilities. Over time however, the number of players declined, as users got too familiar with the games and eventually lost interest in playing. The Internet café business suffered greatly as a result.

In 2004, however, due to the popularity of online gaming, the Internet Café industry grew revenues by an estimated 75%. They were able to double their revenue streams by charging for computer usage (average of PHP30 per hour) **and** selling pre-paid game cards. This fact caused one pundit to call online gaming “the next killer application for the RP<sup>3</sup> Internet and related industries”.

🕒 Increased Subscribership for Telecom Providers

Broadband/DSL subscriptions also rose steadily in 2004, due in large part to online gaming interest. Telco ISPs are leveraging this trend by developing their own online gaming content.

- The largest telecom operator, PLDT, through its content arm, ePLDT, has established a new game distributor/publisher known as NetGames, and has introduced the online game, Khan.
- Bayan Telecommunication has partnered with ABS-CBN Interactive to bring “Tantra” to the Philippines. BayanTel is counting on Tantra to revive demand for their Internet services. They intend to package data services with Tantra.

As a result of Online Gaming and related industries, the following significant opportunities are opening up for U.S. firms in supporting industries, including:

🕒 Servers and Switches

With thousands of gamers playing simultaneously, local content publishers are expected to have the technology to keep up with a multitude of subscribers, 24/7. Such avid usage requires an IT infrastructure, specifically a server farm (including switches), that is expansion ready, reliable and provides consistent output with absolutely no downtime

🕒 Content

There are currently no local developers of online games. Almost all locally distributed online games are imported from Korea. However, U.S. online games have become popular in the Philippines, even prior to being distributed locally. Philippine online gamers actively watch for and participate in trial periods of U.S. online games. Some users have described World of

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<sup>3</sup> RP- Republic of the Philippines

Warcraft (WOW) as “the game everyone’s been waiting for”<sup>4</sup> and Star Wars Galaxies as “one of the biggest and best MMORPGs.”<sup>5</sup> In short, there is significant demand for U.S. online games.

#### ⌚ PC units (New or refurbished)

IDC estimates there will 21.5 million Internet users and 6.3 million online gamers by 2008. Whether the Internet is accessed at home, school, office, or in Internet Café’s, more PC units must be made available for users. In a recent online gaming conference, Intel announced that PCs are still the preferred medium for playing online games. Whether new or refurbished, the minimum system requirements for PCs are: 256 MB RAM, 4X CD-ROM, 32 MB VRAM, 2000 MB disk space, and DirectX v9.0

#### ⌚ Accessories

Online gamers PC accessories include: graphics media accelerators, express graphic utilization tools, high-definition audio, and audio multi-streaming.

### **Import Market**

Online game content is currently 100% imported, almost all of which is developed in Korea. Korean content providers develop games that appeal to the cultural sensitivities of Filipinos. They allow their Philippine publishers to localize the games, making them even more appealing by injecting characters, scenarios and language that are unique to the local culture.

The U.S. is a far second to Korea in terms of market presence. U.S. online games played locally include Half Life II and Empire Earth. Currently, Philippine game publishers are participating in a bid to bring a U.S. developed online game into the market, Vivendi Universal’s World of Warcraft (WOW).

Local game development is limited to PC games and to the console and mobile segments. Anino Entertainment, the maker of the popular “Anito: Defend a Land Enraged,” is the only local PC game developer in the Philippines.

Spoon Interactive Acts, the content development division of ePLDT, possesses expertise in wireless application development, original content creation and consumer Internet applications. They created “GearBox: Puzzle Party”, a “radical hybrid of a fighting and puzzle game,” which was one of the top winners in the Sony Ericsson-sponsored mobile game development contest in September 2004.

### **Competition**

Korea’s Ragnarok is by far the most popular online game in the Philippines. As of Q1 2005, Ragnarok has 300,000 paying subscribers and 50,000 concurrent players worldwide. Philippine Ragnarok Online was opened for beta trial in June 2003 and was released commercially in September 2003.

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<sup>4</sup> Joey Alarilla, Hackenslash, inq7.net

<sup>5</sup> Joey Alarilla, Hackenslash, inq7.net

When asked why Ragnarok is such a big hit, the local publisher, Level Up!, responded that at first, it was because they were pioneers in the market. They managed to retain their top market position because of the quality of the game itself. Before publishing Ragnarok in the Philippines, they “customized” it to fit the Filipino culture – making “the world of Ragnarok a microcosm of Filipino society<sup>6</sup>”. Players converse using the Filipino language, some characters’ names are in reference to popular Filipino citizens, and Filipino humor and traditions are imbedded in the game.

Other locally available online games include:

- ③ Oz World - January 2003 commercial released
- ③ Khan: The Absolute Power - September 2004 open beta trial, February 2005 commercial release
- ③ MU online – August 2004 open beta trial, February 2005 commercial release
- ③ GunBound – December 2004 open beta trial
- ③ Tantra – December 2004 open beta trial
- ③ Prison Tale – January 2005 open beta trial
- ③ Skyblade

The Koreans are still expected to dominate Philippine online gaming content, but industry sources definitely believe the U.S. can catch up. Filipinos have a strong affinity for U.S. products, specifically for popular U.S. films that serve as basis for PC or online games, such as Star Wars and The Matrix. These popular titles will get people interested, but the games need to be interesting and adaptable to keep players. Localizing the games significantly increases their popularity in the local market.

### **End Users**

The Philippine online gaming target market is made up of 10 to 40 years old males and females in the middle and upper socio-economic classes. 4.8 million people are estimated to fall within this demographic. To date, there are only 350,000<sup>7</sup> users, with the most number of concurrent users on a single game pegged at 50,000.

With most of the target market untapped, online game publishers are always on the look out for new and exciting games to launch in the Philippines. U.S. content providers should take advantage of this opportunity and enter the market while it is still in its infancy.

### **Market Access**

Online game content developers should find a local publisher or distributor to effectively penetrate the Philippine market. The publisher may be given the option to localize the game. Several local publishers are currently seeking online game content developers. Once the game is developed and localized, it goes through a beta (open and closed) trial period<sup>8</sup> of three to six months prior to the commercial release.

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<sup>6</sup> “The Business of Online Gaming” by Lisa Gokongwei-Cheng

<sup>7</sup> This number based is on interviews from industry sources, who admit that they are very conservative in releasing information on subscriber base and annual income.

<sup>8</sup> Open Beta Trial Period – allowing free use/access to the online game --- industry practice is 6 months. This is a period during which the game can be played for free and allows players to develop their characters.

There are currently no barriers to entry for U.S. online game developers. The Philippines became a member of the Information Technology Agreement (ITA) under the aegis of the World Trade Organization (WTO) on April 1, 1997. In place since 2000, the ITA effectively eliminated tariff and non-tariff barriers to trade in IT products. Hence, tariff duties for computer hardware, peripherals, and software have been 0% since January 2000, pursuant to Executive Order (EO) No. 163 (Modifying the Nomenclature and the Rates of Import Duty on IT Products). EO 163 was signed by former Philippine President Joseph Estrada on Oct. 18, 1999 in order to implement the commitments made by the Philippines in the ITA.

Computer and related accessories, including software, are subject to 10% Value Added Tax (VAT), computed on the landed cost of the medium. Customized and packaged software are treated the same when they come into the Philippines.

The Philippines has no monitoring capability or set of rules for software purchased and downloaded online. The Philippine E-Commerce and IPR laws do not make provisions for purchases over the Internet.

Two market challenges that potential exporters should consider are: (1) piracy and the (2) prevailing perception that gaming is an “addictive and evil form of entertainment.”<sup>9</sup>

Given the subscription based business model of online gaming, the issue of piracy is not a major problem, as previously described. However, it should be noted that the Philippines, along with 16 other countries<sup>10</sup>, is included in the International Intellectual Property Alliance (IIPA) “priority watch list” of the world’s worst violators of intellectual property rights.

Another challenge is the common perception that gaming is an addictive and “evil” form of entertainment. Gaming industry representatives are addressing this by conducting a full-scale PR campaign. They are effectively communicating to school officials, public officials and private citizens that computer gaming is a formal, legitimate business sector and that the country stands to gain if this industry continues to flourish.

## **Market Entry**

While the U.S. is a strong leader in the Philippine PC-based games industry, it has yet to establish a substantial presence in the online segment. A major decision factor is whether U.S. developers will agree to localize the game, making it socially appealing to Filipino players. As shown by Ragnarok’s success – the local culture’s reflection in the game plays a vital role in gaining a strong following in the target market.

To review, industry sources have identified some simple, useful reminders for game developers seeking to enter the Philippine online game market:

- ⌚ Protect your content against piracy through Digital Rites Management (DRM)
- ⌚ Retail or “sachet” marketing is the preferred business model, as consumers tend to veer away from products that require high front-end costs.

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<sup>9</sup> Quote from Raymond Ricafort, President, Digital Paradise, Inc.

<sup>10</sup> Argentina, Brazil, Bulgaria, Colombia, Dominican Republic, Egypt, India, Indonesia, Israel, Kuwait, Lebanon, Poland, Russian Federation, South Korea, Taiwan and Thailand.

- 🕒 The culture prefers interactive, persistent games with evolving roles and situations.
- 🕒 It is more profitable to shift from high, upfront costs to more affordable but recurring costs.

### **Opportunities for Market Entry**

Please contact the U.S. Commercial Service in Manila ([manila.office.box@mail.doc.gov](mailto:manila.office.box@mail.doc.gov)) for additional information, key contacts and updates on market prospects.

### **Key Contacts**

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